SRD Grazing Lease Rental Rates

Special Areas
Spring Advisory Council

April 2nd, 2009

Agenda

Scope

Background

Options and Examples

Cost Survey

Two Options

Preferred Rent Structure

Questions

Developing Grazing Lease Rent Options – Scope

Research and review comparable systems

Identify and prioritize options

Develop and refine 2 - 3 feasible cost/revenue models

Identify key issues and a preferred option

Develop data/make assumptions to fill gaps

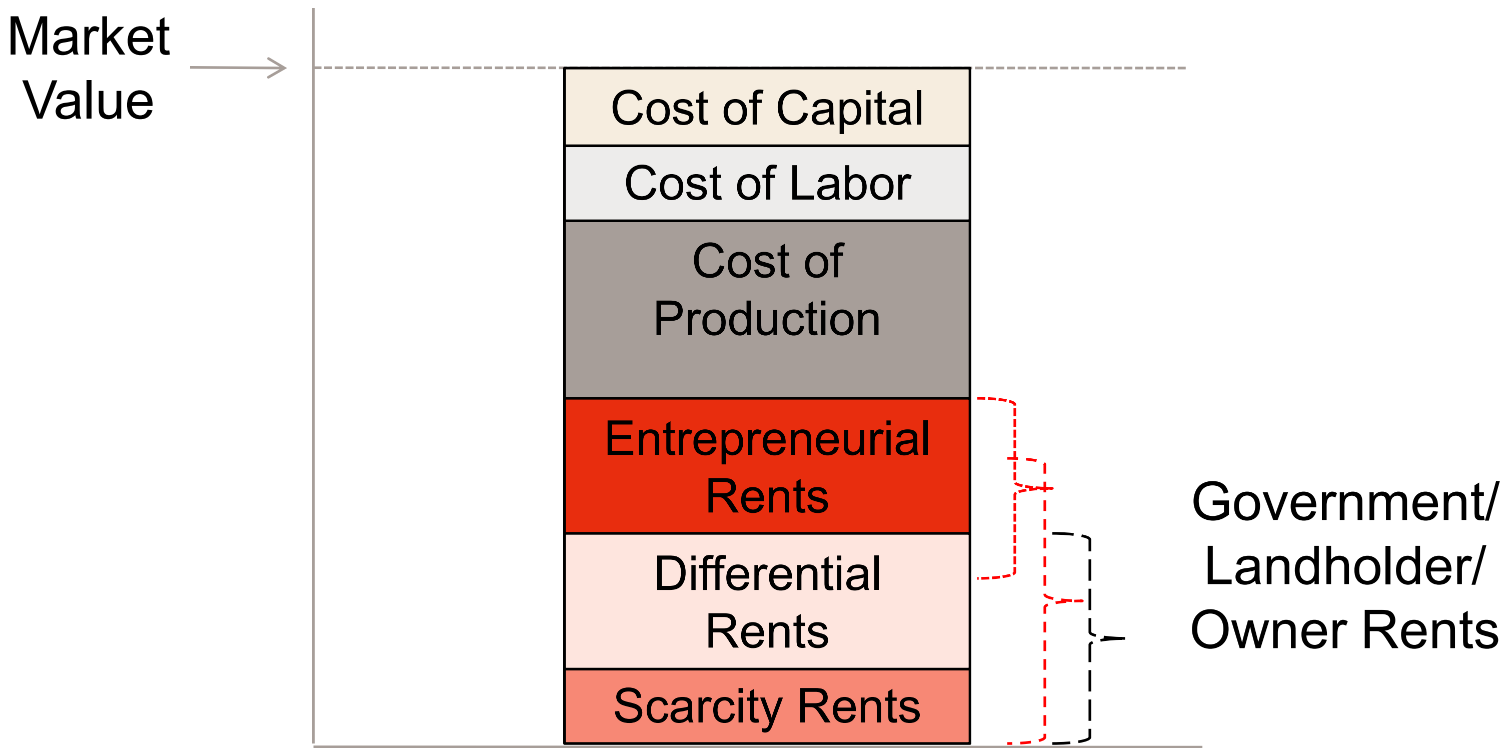
Firm-up the option

This is a "work in process".

Alberta Grazing Lease Rent

CONTEXT

What Is Economic (Resource) Rent?



Public Resource Rent Options

Option	Market Benchmark	Adjustments/ Considerations	Examples
Market Pricing	Auction price at a sale	Upset prices.	Montana grazing; USFS and US state timber; some Canadian timber
Market-Based Appraisal	Auction/ private sale price	Relative value (quality, production costs)	USFS and BLM grazing; Washington grazing; *Manitoba grazing*; BC, Quebec, New Brunswick timber
Market-Based Administrative	Product price	Production & capital costs	Alberta lumber; OSB & pulp; Ontario lumber & OSB, Alberta conventional oil and gas
Market-Based Other	Product price	None	Oregon grazing; Saskatchewan grazing; *Alberta's pre-1994 grazing rent formula*; oil sands prior to payout
Flat Tax	None	None	

Alberta's Past/Existing Grazing Rates

In the past the amount of rent was determined by a formula (last adjusted in the 1980s):

Rent Owed $/ AUM	**=**	**25 pound weight gain/AUM[1]/year**	**X**	**Average price[2] for cattle (per pound)**	**X**	**Percent royalty – 10% in Zone A (south); 81/3% in Zone B (central); and, 5% in Zone C (north)**

[1]AUM defined as the amount of forage required by one animal unit (mature cow weighing approximately 1,000 pounds that is dry or that has a calf up to six months in age. Also 300 lbs/year = 25 lbs/month.

[2]The average price of cattle, excluding slaughter grades, on the Calgary market for June to November of the previous year.

Short comings exist – the average assumptions on weight gain and profitability, and the retrospective look price among them.

As a result of economic concerns, starting in 1994 rates were frozen at $2.79, $2.32 and $1.39/AUM in Zones A, B and C respectively.

Comparisons – Manitoba

Uses a simple formula:

Rental per lease = A x B

'A' is the number of AUM's that the lease is capable of producing in an average year.

'B', the market cost, is the average cost of renting a private pasture of land in the aspen parkland regions of Manitoba. It is expressed in dollars per AUM determined by a triennial survey and *adjusted* by deducting the additional cost of using the leased lands that is not incurred by renters of private pasture land.

Alberta Grazing Lease Rents

2005 GRAZING LEASEHOLDER COST SURVEY

2005 Cost Survey

Farmers and ranchers pay fees, graze cattle and develop and manage grazing on Crown land, undertaking activities and buying assets that would normally be the land owner's – "in-kind" rent.

Survey of direct and indirect costs of investments and operating expenses:

- Direct costs – labour, service or contract costs fully attributed to lease.
- Indirect costs – owner/operator, family or paid labour from the farm or ranch that were allocated to the lease based on proportion revenue from cattle and proportion of AUMs from grazing leases.
- Direct and indirect costs provide a reasonable picture of in-kind grazing lease holder activities and costs.

The Survey

Item	Direct	Indirect

Capital Costs (20-Year cumulative investment)	• Fence building/rebuilding
	• Range improvement
	• Building/corral construction
	• Road construction
	• Fire protection
	• Dugout development
	• Watering system
		• Depreciation/amortization
		  • equipment
		  • building/corral

Annual Operating Costs	• Property taxes • Direct labor • Supplemental feed costs • Road maintenance • Building/corral maintenance • Fence maintenance • Range maintenance • Fire protection • Multiple use costs	• Person years (including farmer /rancher time) • Repair and maintenance of buildings, corrals, equipment • Fuel costs • Utilities costs • Insurance costs • Interest costs (excluding farmland and residences)

Alberta Grazing Lease Rents

TWO OPTIONS

Rent Based On Private Pasture Prices

<u>Private Pasture</u>

Survey

Market
Rental Rate
($X/AUM)

<u>Public Grazing Lease</u>

Grazing
Lease Rental
Rate
(equals)

Investment &
Operating Costs
(2005 Survey)
(less)

Appraisal
Adjustments
(Less)

Market Rate
($X/AUM)

Market Pasture Rate less Appraisal Adjustments less GL Investment & Operating Costs equals Grazing Lease Rental Rates

Rent Based On Yearling Markets

REDSTONE

Lease Activities

"Net revenue"

less input costs

less operating and labor costs (2005 cost survey)

Market Price & Transportation Cost

Input Value

"Residual Income" from lease activity before ROCE

Output Value

Market Price & Transportation Cost

Rent is a portion of this

Market Value less
Additional Input Costs less
GL Investment & Operating Costs equals
Grazing Lease Rental Rates

Rent Based On Yearling Markets

	Component	Considerations
1	***Revenue*** on sale of the yearling (the product of)	• Prior September Central Alberta yearling price ($/lb.) for 800 to 900 lb. steers • Expected yearling weight in September net of transportation weight loss
2	(less) ***Cost*** of the yearling (the product of)	• Corresponding April Central Alberta yearling price ($/lb.) for 600 to 700 lb. steers • Assumed yearling weight on arriving at the lease – 650 lb. net of transportation weight loss
3	(less) ***Cost*** of transportation	• Cost of trucking the yearling to and from the lease (inflated annually)
4	(less) ***Cost*** while on the grazing lease	• Provincial average costs based on the 2005 survey • Add costs of mortality, vet, sales and minimum rent • Costs in place for 10 years (inflated annually)
5	(equals) *"Calculated Net Earnings"*	

Rent Based On Yearling Markets

	Component	Considerations
6	*Grazing Lease Rent*	• Minimum ($1.30/AUM) when the *Calculated Net Earnings* are less than or equal to zero • When *Net Earnings* turn positive *Rent* would be $1.30 plus a percent of the amount that *Revenue* exceeds *Costs* (initially 20%) • As the price of beef and *Calculated Net Earnings* increase the percentage would grow in 5% increments … from 20% to 25% to 30% to a maximum of 50% • The increase occurs each time the growth in Net Earnings exceed a calculated *Return on Capital Employed (ROCE)* • The *ROCE* is calculated as a 7.5% return on: ✓ Capital investment in the lease (2005 survey) ✓ Capital investment in the yearling and cost of transportation to the lease
7	*Range Sustainability Fund*	• Between 10% and 40% of the *Rent* would be used to address existing gaps in range management activities

Rent Based On Yearling Markets

Examples of rent levels (operating costs and ROCE are 2005 costs adjusted to 2008 for inflation).

	September Steer Price		
Values in $/AUM	@1.07/lb.	@1.25/lb.	@1.50/lb.
4 month revenue/weight gain	$ 51.83	$ 60.55	$ 72.66
Less transportation costs	(8.28)	(8.28)	(8.28)
Less operating costs	(30.52)	(30.52)	(30.52)
Less sales, vet and mortality costs	(12.77)	(13.63)	(14.82)
Equals net earnings	$ 0.26	$ 8.12	$ 19.03
ROCE @ 7.5%	(16.47)	(17.54)	(19.03)
Rent	$ 1.30	$ 2.66	$ 4.85

Why Is This Approach Recommended?

Consistency – other examples of similar rent/royalty systems include:

- Alberta's green coniferous timber stumpage.
- Alberta deciduous stumpage for timber used in OSB and pulp.
- Alberta conventional oil and gas; oil sands royalties after payout.

Availability of independent data – leaseholder cost survey provides adequate information on costs and ROCE, CanFax provides market data.

Flexible and transparent – responsive to price changes and relatively easy to explain.

Contributes to improved management – enables development of a Range Sustainability Fund for management activities that neither the lease holders nor government currently fund.

Market Based Rents for Grazing Leases

QUESTIONS